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Economic Outlook 1980

Bank of America Global Report

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Accelerating worldwide inflation and decreasing economic growth mark the world economy as we enter the 1980s.

Inflation is being sustained by a world liquidity glut caused by excessive money supply growth in nearly every nation during the past few years. Since the breakdown of the Bretton Woods System, the world has experienced double-digit growth rates in the global money supply each year. The lack of control over official international liquidity creation and the concomitant weakening of the balance-of-payments constraint have contributed importantly to this lessening of monetary discipline. It is therefore not surprising that global inflation has averaged 12 percent annually since 1974, and the outlook for the 1980s is not encouraging.

The economic dislocations caused by this inflationary environment are exacerbated by sharp shifts in the global price structure. Most notable are the increases in energy prices since 1974, which have made substantial shifts in energy-use patterns necessary. Many existing energy-inefficient production facilities are now obsolete and new factories have to be designed to economize on the use of scarce energy resources. Consequently, labor productivity will continue to decline and overall economic growth rates will be slower than in the past two decades.

There is little hope that the problems of persistent high inflation and reduced economic growth will be overcome soon. Solutions to these problems will require determination, perseverance, and self-discipline on the part of monetary authorities in efforts to reduce inflationary pressures. At the same time, fiscal policy will have to be more supportive of investment in productive resources. In such an economic environment, the world can again enjoy adequate growth rates that will help to reduce unemployment and improve economic welfare.

The World Economy

Global Prospects— High Inflation, Slowed Growth

Bank of America forecasts that the world economic growth rate will slow to 3 percent in 1980, continuing a trend that has been evident since 1976. At the same time, worldwide inflation will remain in the double-digit range. (See Table 1.)

Less than a year ago, there was cause for optimism. While the U.S. economy was generally expected to slow in late 1979 and early 1980, other industrialized countries appeared ready to accelerate economic activity. Further, the industrialized countries as a group had adjusted rather well to the 1974 oil price increases.

Payments imbalances had been reduced and the international adjustment mechanism seemed to be working well. Many developing countries had accumulated substantial reserves and stretched out their external debt profiles, and they were hopeful that their export promotion and diversification policies would soon yield the desired results.

Instead, the outlook for 1980 is now more discouraging. The primary source of anticipated global difficulties springs from the OPEC decision to double the price of crude petroleum from an average of $12.70 per barrel in 1978 to an average of $23 per barrel in 1980. As a result, economic growth rates around the world will decline, inflation will remain high, and payments imbalances will again widen. While the world as a whole will be able to avoid a recession, many countries will experience difficulty in maintaining adequate growth rates.

The U.S. slowdown will be sharper and more prolonged than initially expected and real GNP will show virtually no growth in 1979 and 1980. At the same time, the fight against inflation will be excruciatingly difficult, even with the Federal Reserve's increasingly tough credit restraints. Inflation is expected to be in or near double digits in 1980.

The European countries were poised for a healthy expansion of economic activity in 1979-80. While they are still expected to show slightly greater growth in 1979 than 1978's 3 percent rate, they will lapse to less than 3 percent growth in 1980. The outlook for the more distant future is no more encouraging.

There are observers, including many in government circles, who do not consider such growth rates a major calamity. They believe that substantially reduced population growth rates justify the more restrained pace of expansion. In any case, unemployment rates will remain high. They will not only extract an opportunity cost, but will also constitute a continuing source of social unrest and force the rest of the population to shoulder a high cost of transfer payments.

Inflation levels remain high, with France and Italy in the

Table 1. World Economic Summary*

		Real GNP			Inflation (CPI)		
	1979 ($ bil)	1978 (percent change)	1979	1980	1978 (percent change)	1979	1980
World	$9,268	4.0	3.3	3.0	11.1	12.3	11.5
North America	2,688	4.0	2.0	-0.4	8.2	11.3	10.4
U.S.	2,359	4.0	1.7	-1.1	7.7	11.2	10.4
Western Europe	2,830	3.0	3.2	2.9	8.6	10.1	9.1
Eastern Europe	1,140	4.3	4.0	4.0	N.A.	N.A.	N.A.
Latin America	422	4.3	4.4	4.8	56.3	44.8	35.8
Asia	1,601	5.8	5.2	5.0	4.9	7.3	7.3
Middle East & North Africa (OPEC)	275	4.0	4.0	4.0	15.0	15.0	20.0
Middle East & North Africa (non-OPEC)	120	5.0	5.0	5.0	24.0	20.0	20.0
Sub-Sahara Africa	192	4.0	2.5	2.5	25.0	20.0	25.0

* Bank of America estimates for 1979; forecasts for 1980.

double-digit range, and even Germany and Switzerland experiencing an upsurge in inflation. This new burst of inflation has several causes, including an excessive monetary expansion in 1978 when Germany's money supply increased by 13.8 percent and Switzerland's by 12.6 percent. Much of this rapid money growth was due to dollar support operations in late 1978. Also significant was the fact that the beneficial price effects from currency appreciation came to an end in November of that year when the dollar began to strengthen. While Germany and Switzerland have taken determined measures to tighten monetary policy this year, the oil price increases will make the fight against inflation considerably more difficult.

Japan also will be affected substantially by oil price increases due to its great dependence on imported energy. Growth will be at a respectable but—for Japan—modest 5 percent in 1979 and 1980, while inflation will accelerate from 3.8 percent in 1978 to about 5 and 6 percent in 1979 and 1980, respectively. A tighter fiscal policy will slow the growth of government expenditures, with the private domestic sector becoming increasingly important as a source of growth in aggregate demand.

It is interesting to note that observers focusing on individual countries tend to be more optimistic than those analyzing the global picture as a whole. This suggests that most problems, when they arise, will be perceived as being of foreign rather than

domestic origin. The inclination to place blame on others and to take actions that tend to shift the problem to other countries will be great. The dangerous implications of this tendency lead to two important conclusions. First, greater international cooperation and policy coordination will be increasingly essential. Second, policy measures should be directed at overcoming problems, rather than at shifting the burden of ultimate adjustment to others. Even so, it is clear that difficult times lie ahead for the world economy.

Policy Response Constrained by Inflation

While there are many parallels between the 1974 and 1979 oil price surges, there is a very important difference in the policy response by the major industrialized countries that will have far-reaching consequences. In 1974, most industrialized nations experienced a shortfall in domestic demand caused by the increased oil payments to OPEC countries. At that time, these nations took action to expand domestic demand and as a result there was only a relatively mild slowdown in 1975. Policy makers learned that those countries which undertook early adjustment measures fared comparatively well over the long term. Of course, much of the success of the German, Japanese, and Swiss policies was also due to the fact that other countries—including most notably the United States—expanded more rapidly.

In contrast, few countries now show any desire to overcome the deleterious consequences of the oil price increases by spending more to make up for the expected demand shortfall. Instead, continued high inflation rates make tight monetary and fiscal policies necessary. All oil importing countries will not be able to improve their payments balances simultaneously. As the industrialized countries experience slow growth and become increasingly frustrated in their attempts to reduce external disequilibrium and to achieve low levels of unemployment, the pressures for protectionism will become greater. If international leaders yield to such protectionist sentiment, the consequences for the health of the world economy, and in particular for the developing countries, will be severe.

Serious Implications for the Developing Countries

The developing countries had, by this year, adjusted rather well to the 1974 oil price increases, which had burdened them with an aggregate current account deficit of $38 billion in 1975. They also had succeeded in building up their international reserves and in improving the term structure of their external debt. To quite an extent, these accomplishments were made possible by the international commercial banking system which gave the developing countries unprecedented access to international financial markets at very favorable terms.

While many of the developing countries seem well prepared to weather the storm ahead, the difficulties confronting them will be numerous.

First of all, many developing countries are highly dependent on petroleum and petroleum-based products for use in farming and transportation. Many of these countries have to rely almost exclusively on road transport, lacking extensive railroad or barge systems that are relatively more energy efficient and capable of using non-petroleum energy sources.

Second, the developing countries will be relatively more vulnerable to the expected slowdown in world trade and a possible escalation of protectionism. This will cloud the outlook for countries that attempt to emulate the successful export-led growth strategies of economies such as Hong Kong, Singapore, and Taiwan.

Third, high absolute levels of interest rates result in high debt service payments. Some developing countries will find it increasingly difficult to meet their commitments. The problem will be compounded by the fact that many banks are not eager to increase their exposure and, consequently, there may be a tendency toward even higher interest rates on credits to these countries.

Fourth, population pressures in many developing countries continue unabated. The problem of high birthrates is frequently compounded by a tendency of the population to migrate to urban areas, further exacerbating unemployment problems in large cities. The low economic growth rates that may be acceptable to industrialized countries with stable populations mean falling per capita incomes in countries with rapidly expanding populations. The resulting social pressures and tensions may become very severe.

The latest OPEC price increases confront the developing countries at a time when they have barely adjusted to the 1974 increases. A determined effort by international agencies will be necessary to provide adequate resources to the most seriously affected countries, while the commercial banking system will again have to perform the task of recycling the bulk of the OPEC surplus to the advanced developing and the industrialized countries.

Reduced Growth in World Trade

The 1979-80 economic slowdown will lead to a sharp reduction in the growth rate of world trade. Export growth is expected to fall from around 16 percent in 1979 to little more than 13 percent in 1980. (See Table 2 on page 6.) The drop becomes even more pronounced when adjusted for price increases, with growth rates falling from roughly 3 percent in 1979 to 1 percent in 1980.

The doubling of oil prices between 1978 and 1980 will have a signficant impact on world trade. Higher energy prices will mean larger deficits for the oil importing countries as they struggle to pay higher energy bills, maintain industrial goods imports, and service international debts. Of potentially greater long-term impact, however, is the effect of reduced non-oil imports on trade flows, particularly on the newly industrializing countries. It is difficult to see how the developing countries will be able to increase

Table 2. World Trade*

	Exports				Imports			
	1979 ($ bil)	1978 (percent change)	1979 (percent change)	1980 (percent change)	1979 ($ bil)	1978 (percent change)	1979 (percent change)	1980 (percent change)
World	$1,363	15.6	16.2	13.1	$1,367	16.3	17.5	13.2
North America	242	15.7	24.7	15.9	269	15.1	18.9	11.9
U.S.	182	17.7	28.4	16.0	210	16.1	20.0	11.0
Western Europe	614	21.0	14.6	12.1	613	15.3	16.9	12.9
Eastern Europe	40	10.0	10.0	10.0	50	10.0	5.0	8.0
Middle East & North Africa	156	-4.0	27.0	19.1	122	18.0	23.0	23.0
Sub-Sahara Africa	51	10.0	8.0	8.0	56	22.0	15.0	15.0
Latin America	47	2.1	5.9	8.4	48	13.1	7.0	7.4
Asia	213	18.2	9.4	11.5	209	18.7	21.3	12.6

* Bank of America estimates for 1979; forecasts for 1980.

their exports sufficiently to maintain satisfactory real growth rates of per capita income and to meet international financial obligations.

The less developed countries were able to increase their exports of manufactured goods sharply during the last decade. However, they are still heavily dependent on the export of raw materials while international price trends continue to favor manufacturing.

The growth in exports, necessary to maintain current economic programs in developing and industrial countries alike, is threatened by the continuing high worldwide inflation and the slowing overall growth rates in the industrial countries. Given the slowdown in the industrialized countries and its detrimental effects on employment, protectionist sentiments may well increase in the key industrialized nations. Consequently, the trend to slower growth will gradually spread to the non-industrial countries.

One hope for continued expansion of world trade is the new trade liberalization agreement now being ratified by the 99 countries which participated in the "Tokyo Round" negotiations. The major provisions of the Multilateral Trade Negotiations (MTN), conducted within the General Agreement on Trade and Tariffs framework, are for tariff reductions on manufactures, averaging 30 percent from their current levels, and a new set of trade codes, including procedures for the resolution of conflicts over trade. The new codes concerning subsidies, government procurements, product standards, customs valuation, and import li-

censing are much more important to the flow of world trade than tariff cuts because the average tariff on industrial goods is already low, about 8 to 10 percent in most industrialized countries.

The new codes will not remove all the barriers to free trade and will not resolve all the issues which threaten world trading relationships, but they represent a positive element in an otherwise troublesome world trade outlook.

Current Account Balances Weaken Again

Current account balances of virtually all non-OPEC countries, with the exception of the United States, will deteriorate in 1980. Although the sharp increase in the price of oil underlies much of this deterioration, increased import demand also is a factor in many industrialized countries and in the more advanced developing countries.

After a series of large deficits, which began in 1973-74, the industrialized countries resumed their position as net suppliers of real resources to the world in 1978, when a surplus of $32.5 billion was registered by the 14 most industrialized nations. This surplus declined sharply in 1979, to about $16.5 billion. A surplus of $21 billion is projected for 1980. The most notable changes will occur in Japan, Germany, and the U.S. A sharp decline in the current account surplus of Germany and Japan is expected. While the U.S. current account will be in near balance in early 1980, the resumption of U.S. economic growth is expected to again lead to a substantial U.S. deficit, rekindling downward pressure on the dollar. Because those developed countries that are less industrialized will run a large deficit, the developed countries as a group are expected to have a surplus of only $9 billion in 1979 and $11 billion in 1980. (See Table 3.)

Of course, global numbers of the magnitude described here are

Table 3. Current Account Balances
(in billions of dollars)

	1977	1978	1979*	1980*
Developed Countries	-14	25	9	11
OPEC	34	15	43	50
Developing Countries	-24	-30	-45	-52
Centrally Planned Economies	-3	-4	-7	-9
Statistical Discrepancy	7	-6	---	---

* Bank of America estimates.

subject to a considerable margin of error as is evident in the "statistical discrepancy" contained in the official data for years past.

The OPEC surplus will widen to approximately $50 billion in 1980, a large increase over 1979's $43 billion and a very substantial increase from the $14.8 billion recorded in 1978. These surpluses are smaller than the $68 billion surplus experienced in 1974, reflecting the fact that several OPEC countries—most notably Venezuela, Nigeria, and Indonesia—are now running deficits. It may well be argued that the current account deficits experienced by a vocal segment of the OPEC countries were a significant factor—in addition to the Iranian upheaval—in triggering the current round of oil price increases.

Also, the absorptive capacity of the OPEC nations has substantially increased with many ambitious development plans now in the advanced stage.

The current account deficit of the non-OPEC developing countries will worsen by $15 billion in 1979, to $45 billion, and by a further $7 billion in 1980. Although this overall deficit should be financed without excessive strain on financial markets, performance in this country group is uneven. Many of the more dynamic countries in this group now enjoy a comfortable level of international reserves that can be used to offset shortfalls in capital inflows. These countries also tend to have access to financing from private sources. However, several other countries will be facing difficulties with stabilization programs. In the aggregate, the size of the overall deficit implies that many countries will have to adjust their total expenditures to bring them into line with available capital.

In some instances, already accumulated debt will hinder a country's ability to tap additional resources. This suggests that many deficit countries will have to reduce growth rates to balance the supply and demand for funds. The more dynamic of the non-OPEC developing countries in particular will need continued access to the markets of the industrial countries. Their output of manufactured goods is increasing and reliance on a few primary products is being replaced by a more diversified composition of exports.

The current account deficit of COMECON (East bloc) nations with the rest of the world was equal to about $4 billion for 1978. The projected deficit in their current account for 1979 and 1980 will be higher and, as in the past, will be financed largely in the Euromarket and by official Western government credits. The development strategy adopted at the beginning of the 1970s, based on large imports of Western capital goods and raw materials on credit, has reached its limits; export performance has failed to meet expectations, and debt levels have exceeded original plans. The response has been to limit imports and accept lower growth in GNP and investment.

China is expected to run deficits of increasing magnitude, leading to a rising current account deficit for the group of centrally planned economies as a whole.

In total, the OPEC surpluses of $43 billion and $50 billion in 1979 and 1980 will be mirrored in $45 billion and $52 billion deficits for the developing countries. At the same time, the increasing deficits of the centrally planned economies will be financed by surpluses of equivalent size in the developed countries.

Foreign Exchange Markets Face Uncertainty Ahead

The U.S. dollar experienced a period of recovery in early 1979 and relative stability is expected in the remainder of the year. However, downward pressure on the U.S. dollar is expected in 1980. It will take determined policy measures by the U.S. administration to forestall another round of dollar depreciation against the other major currencies.

The November 1, 1978 money and exchange market actions taken by the U.S. authorities set the stage for a sustained recovery of the dollar during the following half year. Between the end of October 1978 and the end of May 1979 the dollar appreciated from 180 yen to 221 yen and from DM 1.78 to DM 1.92. The real effective exchange rate of the dollar, which measures the change in the value of the currency compared to all trading partners and corrected for inflation differentials, improved by 4 percent over the same period.

The improvement in the dollar exchange rate was due to developments in both the current and capital accounts. The current account moved into a surplus position of $200 million in the first quarter of 1979—the first surplus since 1975. The slowdown in the U.S. economy also resulted in a significant decline in the growth rate of imports, while the beneficial price effects of the previous dollar depreciation led to an export surge and a signficant increase in the world market share of U.S. exports in 1979.

At the same time, there was a net capital inflow of over $30 billion in the first half of 1979, more than offsetting the 1978 outflow. An important motivating factor behind these capital flows was provided by the wide interest differentials that prevailed in late 1978 and early 1979 between the dollar and the other major currencies. Interest rate differentials on three-month Eurodeposits reached 11 percentage points between the Eurodollar and the Swiss franc, 9 percentage points between the Eurodollar and the yen, and 8 percentage points between the Eurodollar and the mark.

The dollar ceased to appreciate in early June, with some renewed weakness in evidence after OPEC announced its latest round of price increases. As the European economies slow down and tight monetary policies begin to bite, both the growth and the interest differentials are no longer favoring the dollar as much as they did in early 1979.

It is likely that a temporary plateau in the exchange value of the dollar has been reached. Given the slowdown in the U.S. economy and the increasingly tight monetary policy pursued by the Federal Reserve, the dollar should hold approximately the current level for the remainder of 1979, as measured against the

weighted average of the currencies of the U.S. trading partners. However, there are likely to be significant short-term fluctuations around this level as exchange markets reflect diverse economic developments.

In 1980, several factors may create a renewed bearish outlook for the dollar. First, U.S. growth and imports will pick up again. Second, inflation in the United States will remain high while it will decrease in its main competitor countries. Third, U.S. short-term interest rates are likely to decline considerably while those in the major competitor countries will remain stable or decline only modestly.

Another potentially disturbing factor for the dollar is provided by the European Monetary System. Until now the EMS has operated very smoothly, but this period of calmness may well be limited. In an unexpected way, the formation of the EMS strengthened the currencies of the weaker economies, like France, Italy and Ireland.

Because of their high inflation rates these countries also have high interest rates compared to Germany. When exchange rates were free to react to market forces, the interest gains could be expected to be offset by exchange rate losses. But because the EMS has enhanced the degree of expected exchange rate stability, the exchange rate risk has been reduced, at least in the short term. Consequently, the high interest yields have become very attractive, resulting in short-term capital inflows into the high inflation countries. This, in turn, tended to push up the exchange rates of the weaker currencies even more.

Of course, this situation cannot persist indefinitely. The September 1979 realignment demonstrated the willingness of authorities to act in anticipation of the market. The adjustments, however, were modest. Unless further exchange rate changes are implemented in a timely fashion, doubts regarding the viability of the present exchange rate structure may lead to large and volatile international capital movements among the EMS member countries. This could produce sharp pressures on the currencies of countries with high inflation rates.

The outlook for the U.S. inflation rate continues to be gloomy. This one factor—more than anything else—will eventually become the dominating force in the exchange rate relationship, possibly leading to a renewed secular decline of the U.S. currency over the next year or two, unless U.S. authorities take strong countermeasures.

Regional Trends

U.S. Economic Outlook—Recovery in Mid-1980

Growth—The U.S. seems to be on a well-established path to recession. Though the decline in real GNP which started in the second quarter of 1979 was apparently halted in the third quarter, the economy has been generally sluggish throughout the year. Resumption of the decline is expected in the fourth quarter and will likely continue through the first quarter of 1980, with a weak recovery underway by mid-year. (See Table 4.)

With an expected peak-to-trough decline in real GNP of about 1.5 to 2 percent, this downturn would be in the middle range of postwar recessions in terms of depth and duration.

The recession is attributable to high levels of inflation, interest rates, and debt burdens, combined with restrictive monetary policy. Inflation remains the main culprit, retarding growth of real

Table 4. Selected Economic Indicators for the U.S. 1978-1980*

	1979 Quarters				1980 Quarters				Years		
Percent Change	1	2	3	4	1	2	3	4	1978	1979	1980
Real GNP	1.1	-2.3	1.0	-4.0	-3.1	0.4	1.8	2.4	4.4	1.7	-1.1
Consumer Prices	11.1	13.6	13.4	11.4	9.5	9.0	9.0	9.0	7.7	11.2	10.4
Personal Consumption	11.4	6.1	13.9	6.7	7.4	8.5	10.0	11.9	11.6	11.1	8.8
Consumer Durables	3.2	-9.2	8.8	-11.1	0.2	3.2	4.2	13.3	12.0	5.2	0.2
Plant and Equipment Investment	13.0	9.7	11.5	6.9	3.5	3.5	3.3	5.2	16.7	14.0	5.5
Unemployment Rate (percent)	5.7	5.7	6.0	3.3	6.9	7.4	7.6	7.8	6.0	6.0	7.4
Net Exports (in $ billions)	4.0	-8.1	-5.6	-2.4	1.0	2.4	3.1	2.9	-10.3	-3.0	2.4

*Figures from third quarter 1979 through 1980 are forecasts by Bank of America. All quarterly figures are seasonally adjusted annual rates. Net Exports on National Income Accounts basis.

income and wealth, distorting spending patterns, pushing interest rates higher, and forcing restrictive monetary policy.

The U.S. downturn will be broad based. High debt burdens and weak real income growth will cause a downturn in consumption demand concentrated in consumer durables, particularly automobiles. These same forces, combined with the high cost and reduced availability of funds, will lead to a decline in residential construction continuing through mid-1980.

The widespread view that the downturn will be concentrated in consumption and housing while output is held up by strong business fixed investment must be abandoned. Business spending plans have already been pared in response to the evidence of a weakening economy and will be cut further as the fall-off in sales continues.

Growth is expected to turn positive again in mid-1980 under the stimulus of renewed consumer demand combined with a recovery in housing and business investment.

Inflation—With relatively high employment, inflation is being driven by strong demand-pull pressures exacerbated by rapidly rising food prices and very large increases in energy prices. The price guidelines are having, at most, a marginal effect and any significant relief from inflation must come from slower growth.

The latest OPEC price increases, combined with domestic energy price decontrol, will keep energy prices rising at very high rates throughout 1979. But after that, rates of increase in energy prices, although remaining high, will slow down. With luck, food prices will continue their recent moderation. The recession will lower rates of increase for cyclically sensitive prices. These factors should result in a decline of quarterly inflation rates to the 9 percent range by mid-1980.

Labor costs, however, will put a floor on price declines. The wage guidelines have been quite effective in holding down wage increases, particularly in the nonunion sector. This is unlikely to last much longer as workers have experienced a steady decline in their standard of living for the past year and a half. Some recent union settlements have broken the 7 percent guideline. The weakening of the guidelines and the upward pressure on wages from price inflation both point to an acceleration of wage increases. The possibility of a wage explosion poses a major threat to the expected near-term moderation of inflation.

Economic Policies—Although there are signs of economic weakening, which traditionally bring forth calls for stimulative policy actions, there is now wide recognition of the need to fight inflation and defend the dollar. The chief burden of this fight must be assumed, as usual, by the Federal Reserve. The central bank's dramatic steps in early October to control credit expansion are likely to accelerate the rise in interest rates, but also could bring about a swifter peaking-out of both interest rates and credit growth.

The Federal Reserve is likely to get little new support from the fiscal side. On the other hand,

this time Administration and Congressional moves toward more fiscal ease may be both slower in coming and more moderate in degree than during past economic slowdowns.

The dollar held steady through the first half of 1979 but stands in a tenuous and easily disturbed equilibrium. The latest OPEC-imposed oil price increase will intensify inflationary pressures, retard improvement in U.S. balance of payments deficits, and put renewed pressures on the dollar. Unless inflation improves during the coming year, the international community is likely to lose confidence in the ability of the U.S. to handle its affairs responsibly. The result would be a renewed spiral of depreciation and further inflationary pressure.

These considerations suggest that the fight against inflation will remain the main priority in the near term and fiscal policy will remain mildly contractionary during the remainder of 1979. The most that can be expected from fiscal policy is some speeding up of already budgeted spending.

However, as output falls, the pressures for stimulus will rise. Slow growth, rising unemployment, public resentment against inflation-induced increases in taxes, and the approach of the 1980 elections will create strong pressures for fiscal stimulus by early 1980. But given the public mood, a sharp expansion of government spending programs is unlikely. Instead, it is probable that a moderate tax cut will be approved. However, the effects of such a tax cut are likely to be felt only in late 1980 or early 1981.

Canada—Moderate Acceleration

The Canadian economy is expected to expand by almost 4 percent in 1980, following three years of more modest growth. Investment spending will accelerate, bolstered by continued growth in profits, rising capacity utilization, and the need for plant modernization. After four years of declining housing starts, an upturn in residential construction is expected in 1980. Strong growth in real disposable income in 1980 will support a rise in consumer spending as the year progresses.

Inflation will register about 9 percent in 1979, falling to 8 percent in 1980—well below the rate anticipated in the United States. The lackluster economic performance of the U.S. economy in 1979 will notably curtail demand for Canada's exports, despite considerable improvement in its competitive position. As a result, the already large current account deficit is likely to deteriorate in 1979 to about $6 billion, increasing further to $6.5 billion in 1980.

The government has announced plans to encourage the development of a free-market economy and to reduce the role of the public sector. This has resulted in spending cuts, a reduction of government transfers, and lower taxes, all of which bode well for the long-term prospects of the Canadian economy.

Mexico—
Oil Exports Aid Solid Growth

The Mexican economy will continue to grow between 6 and 7 percent in 1980, following the pattern of 1978 and 1979. Growth will be concentrated in the manufacturing and industrial sectors, particularly in the petroleum and petrochemical industries where output has increased by an average of 10 percent during the last two years. The agricultural sector will show some improvements, increasing output by 5 percent in 1979 and 6 to 8 percent in 1980.

Relatively high rates of economic growth in urban and border areas as well as in the oil regions have led to massive shifts in Mexico's population. Eight of the fastest growing cities in Mexico are within 50 miles of the U.S. border, and Mexico City is growing rapidly with an influx of approximately 500,000 people per year.

To ease social tensions and provide employment for semi-skilled migrants, the Mexican government has increased spending on public works projects with high employment impacts. Deficit financing has led to money supply growth exceeding 30 percent for the past two years. Accordingly, inflation will be near 20 percent in 1979.

The determined efforts by the administration should reduce inflation to about 16 percent in 1980.

Mexico's trade deficits will continue despite improvements in the border trade and tourism sectors. The country's accelerating growth rate has increased the demand for imports. A current account deficit of $2 to $3 billion is expected in 1980, about the same as 1979. Increases in the production and export of oil combined with increases in the price of oil and natural gas will produce $7 to $9 billion in energy export revenues by 1982. This development will considerably reduce pressure on the balance of payments and the peso.

Mexico's reserves of oil and natural gas are very large. Even using the most conservative estimates, Mexico has sufficient reserves to export between 1 and 1.5 million barrels per day for the next 40 years.

Latin America—
Export Growth Uncertain

For the countries of Latin America, the worldwide economic slowdown, higher energy costs, and spreading protectionist sentiment will mean slower growth rates, increased difficulty in reducing the rate of inflation, and higher balance of payments deficits.

Gross Domestic Product growth rates for the region will be between 4 and 5 percent in 1980, in line with the level of recent years. Domestic markets are not yet strong enough in most countries to sustain steady economic growth. Thus, export markets are required if real advances in per capita income are to be sustained.

Inflation in Latin America will decline, but from a level which continues to be the highest of any region in the world. The regional inflation rate is heavily influenced by Brazil which produces one-half of the region's

GDP and will incur about 35 percent inflation in 1980; and Argentina where inflation will be an estimated 85 percent in 1980. For the region, inflation is likely to ease to around 35 percent in 1980 from 45 percent in 1979 as Argentina and Brazil continue in their efforts to reduce inflation.

International trade is extremely important to the economies of Latin America. Imports continue to increase and will climb an estimated 7.4 percent for the region in 1980. Individual countries may be able to cut imports in response to balance of payments or foreign exchange pressures, but, overall, the region will require substantial imports of capital goods and industrial inputs for economic growth.

Most of the South American countries are either oil exporters (Venezuela, Ecuador, Trinidad, and Peru) or virtually energy self-sufficient (Chile, Colombia, Bolivia, and Argentina). Brazil, however, depends heavily on imports of petroleum. The additional cost of oil imports to Brazil due to the 1979-80 price increases are in the $1.5 to $2 billion range. The impact of the oil price increases will also be severely felt in Central America.

Exports of non-traditional goods such as basic capital goods and heavy equipment and machinery now account for nearly 40 percent of Latin America's exports, testifying to the growing strength and maturity of economies of the region, particularly in the larger countries. Continued progress, however, depends on finding new markets as well as maintaining old ones. Slower growth rates in the industrial countries will retard the demand for Latin American exports, and if protectionist barriers are erected, Latin American export growth will be further curtailed. The combination of higher energy prices and slower export growth will result in a trade deficit for Latin America of between $1 and $2 billion dollars annually in 1979 and 1980. The region's current account deficit in 1980 will be about $15 billion, financed from reserves and from borrowing abroad.

The level of foreign debt has increased during the last two years, reflecting the decision of Latin American authorities to take advantage of favorable borrowing conditions in international markets. These are essentially portfolio decisions which will build up reserves or lighten debt servicing burdens by reducing spreads and lengthening maturities.

Western Europe—Inflation Rising Again

The acceleration of European economic activity, evident since late 1978, will abate before year-end 1979 and slower growth will carry over into 1980. Inflation is again rising, and this, combined with limited supplies of petroleum, is reducing consumer and business confidence.

Rising political conservatism will encourage anti-inflationary policies at the expense of employment and growth in 1980. With the operation of the EMS, a restrictive monetary policy is likely to prevail among member countries. To facilitate maintenance of currency parities, increasing em-

phasis will be placed on interest rate relationships.

Average real GNP growth in Western Europe is expected to decline to 2.5 to 3 percent in 1980. Although investment for capacity expansion will take place in some countries, most investment expenditures will go to rationalize existing plants so as to enhance labor productivity and to meet regulatory requirements. Continuing productivity gains will help maintain a modest but stable growth in personal income. This will support moderate consumption growth despite tightening credit conditions.

The marked decrease in inflation rates in Europe during 1977 and 1978 has halted. Rising energy and raw material prices, the dollar appreciation in the first half of 1979, and excess liquidity in most countries of the area will raise the European inflation rate to over 10 percent in 1979. The tight monetary policies pursued by most countries should lower this rate to approximately 9 percent in 1980.

Current account balances, after an almost uniform improvement in 1978, deteriorated in 1979. This was the result of strengthened domestic demand and rising import bills for petroleum and other raw materials, coincident with weakened import demand and the increased export-price competitiveness of the United States. In 1980, no significant balance of payments improvement is expected in Europe, despite the anticipated slowdown in the region.

Member countries have a strong commitment to the EMS and have devised an effective support mechanism for its defense. The September 1979 realignment indicates that the authorities are willing and able to react to changing circumstances in a flexible manner. Even so, the viability of the EMS could be severely threatened by a prolonged period of dollar weakness or by the continued divergence of inflation rates among the EMS member countries.

Eastern Europe—Strategy Revision

The development strategy adopted by most East European countries earlier in the decade, based on large-scale import of Western technology and equipment on credit, is undergoing revision in most countries of the region. The strategy failed in a number of assumptions: the debt burden is higher than anticipated, export performance (necessary for repayment of credits) has not improved dramatically, and the economies were not prepared to absorb the new technology efficiently. This has caused delays in completion of projects, lower quality, and unexpectedly high domestic costs.

Although the approach provided a signficant contribution to the regional economy, the expectations were excessive. Complex systematic reforms are politically precarious, and minor reforms and ad hoc measures, though important and relevant in many cases, are not sufficient to invigorate the economies. Growth rates in Eastern Europe thus continue to be below both those experienced in the past and those

targeted in the current five-year plans.

East-West trade will remain at the present level of $50 billion as restrictions on nonessential imports remain in effect. The region will import increasing volumes of grain, industrial raw materials, fuel, and machinery. Exports will grow moderately, resulting in a $10 billion trade deficit and a $7 billion current account deficit for 1980.

Middle East and North Africa—Oil Makes the Difference

OPEC Members

Economic growth in the oil producing countries of the Middle East and Northern Africa should approximate 4 percent in 1980, about the same rate as in 1979. Higher growth rates in Algeria and Iraq will offset the continued slow growth in Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. Lack of absorptive capacity and scarcity of skilled labor are major impediments to higher growth. In addition, the Gulf oil states are cautious regarding the introduction of Western industrial technology.

Inflation in most of the Middle East and North Africa OPEC nations has been declining in recent years. However, there will be renewed inflationary pressures in 1980. Rising costs of imports and shifts in relative prices are likely to result in a 20 percent increase in consumer prices in 1980, up from 15 percent in 1979.

Oil output by OPEC members in the Middle East and North Africa will be 24 million barrels per day in 1980, representing 82 percent of total OPEC production. Kuwait, Iran and Iraq are unlikely to increase production in 1980 although they have substantial excess capacity.

The burden of meeting world demand for oil will fall on Saudi Arabia. Whether or not the Saudi decision to increase oil output to 9.5 million barrels a day is extended into 1980 will depend largely upon the satisfactory resolution of outstanding political issues. Even with a Saudi increase in production, a slight excess demand for oil will continue to prevail in 1980. This will encourage countries with low levels of oil reserves and declining production to press for higher oil prices in 1980.

If the major industrialized countries adhere to the Tokyo agreement restricting oil consumption between 1980 and 1985, the prospects for significant oil price increases in 1980 will be reduced. Overall, oil prices will probably increase at the world inflation rate.

Although imports will rise by 25 percent, the current account surplus for the OPEC members in the Middle East and North Africa should reach $55 billion in 1980.

The nominal value of the gross foreign assets held by the OPEC countries in the region are expected to reach about $190 billion in 1980, up $30 billion from 1979.

Non-OPEC Countries

In the non-oil producing countries of the Middle East and North Africa, real GDP growth will be about 5 percent in both 1979 and 1980. However, growth in the larger economies, such as Egypt,

Israel, Morocco, and Pakistan, will continue to be constrained by inflation and by heavy external debt service. The mining and industrial sectors will continue to make a strong contribution to GDP growth, while agriculture will remain weak. Dependence on external aid for budgetary and balance of payments support will persist in 1980.

Inflation in these countries will be around 20 percent in 1979 and 1980. Continued growth in private and government expenditures and monetary expansion are major factors contributing to high rates of inflation.

Increases in oil prices will result in a growing trade deficit, reaching approximately $18 billion in 1980. An expected large positive balance in non-trade items will partially offset the growing trade deficit. The largest component of this "invisibles" balance originates from government transfers in the form of grants from the Arab oil producing countries. In addition, workers' remittances will also help to finance the trade deficit. As a result, the aggregate current account deficit of the non-oil producing countries of the Middle East will be around $10 billion in 1980.

Sub-Sahara Africa—Agriculture Outlook Discouraging

Real GDP growth in 1980 for Sub-Sahara Africa is estimated to be 2.5 percent, but the prospect of a population increase of 2.7 percent will keep the per capita growth rate declining. The principal reasons for negative growth will be: increasingly unfavorable terms of trade; slowing growth rates in the industrial countries on which the region depends for its major export markets; and drought conditions that have adversely affected agriculture.

The rate of inflation will increase from 20 percent in 1979 to 25 percent in 1980. The expected acceleration in inflation is attributable to increases in oil prices, budgetary deficits, and the increasing cost of imported investment goods.

The industrial and mining sectors enjoy a promising long-term outlook. The industrial sector will continue to expand as countries attempt to establish domestic industries and reduce dependence on imports of consumer goods. In individual countries, the small size of the market presently restricts industrial expansion. For the region as a whole, this constraint will be remedied as the move towards sub-regional integration progresses. However, integration is still in its preliminary stages. Therefore, its benefits will not be evident in 1980.

The outlook for the mining sector improved following the confirmation of commercially exploitable petroleum reserves in Chad and Ivory Coast and the prospect of such reserves in Ghana. However, as with sub-regional integration, material economic benefits are not yet likely to be apparent in 1980.

The agricultural situation remains discouraging for many reasons. First, the region as a whole, and in particular the area just south of the Sahara, is faced with adverse weather conditions. Second, the cost of fertilizers will continue to rise, following the

persistent increase in oil prices. Third, the technology of cultivation remains rudimentary. Together, these factors will continue to limit agricultural production, exacerbating the problem of matching food demand and supply in 1980.

During the coming year, an increasing need for grain imports will cause signficant pressure on the balance of payments. In addition, debt service obligations and imports of investment goods will further increase the demand for foreign exchange. Since Sub-Sahara Africa continues to depend on commodities that fluctuate sharply in price—copper, cocoa, and sisal—instability of export earnings will remain an acute problem. As a result, the current account deficit is expected to total approximately $10 to $11 billion in 1980, about the same level as in 1979. The total debt of the region will surpass $50 billion.

The region is likely to continue to see periodic political turmoil in the 1980s. It will also be a focus of conflict among major world powers. The political instability of most African regimes continues to stem from a weakness of national political institutions, an absence of cohesive national identity, conflicting tribal loyalties, and strong-man political rule. Despite such instability, the leaders of Sub-Sahara Africa will attempt to modernize their economies and minimize the technological gap with the developed world. They will probably become more pragmatic and less ideologically rigid in an attempt to create favorable conditions for foreign investment.

Asia—
Export Demand Weakens

In Asia, the outlook is for continued slow growth, high inflation, and widening current account deficits in 1980.

Japan is expected to maintain a 5 percent real growth rate in 1980. This reflects renewed strength in its current account, due largely to an anticipated improvement in the country's terms of trade and a substantial increase in its foreign investment earnings. On the other hand, some weakening of the domestic sector is anticipated because of a deceleration of private investment associated with the uncertain oil outlook. Fiscal stimulus is likely to be limited.

The major cause of slower growth in the highly export-oriented economies of East Asia—Taiwan and Korea—will be a weakening of demand in their major export markets. Despite occasional surges in exports, these countries will not be able to maintain the rapid export expansion of the past and will have to rely increasingly on the domestic sector to achieve a balanced pattern of growth.

Less buoyant domestic demand will be the prime source of dampened growth among Southeast Asian countries. In many countries, the rapid expansion of government expenditures, which was the major stimulus to growth over the last couple of years, is being curtailed because of burgeoning budget deficits. Moreover, some weakening in the recent recovery of private invest-

ment is also likely because of higher inflation and tighter credit conditions.

Asia's inflation rate will remain high in 1980, after accelerating in 1979. This will reflect higher oil prices in addition to the sharp wage increases and rapid monetary expansion registered over the past two years. To combat the rising tide of inflation, as well as widening budget and current account deficits, many Asian countries will be shifting to more restrictive fiscal and monetary policies.

The uncertain outlook for Asia's important export markets, accelerating inflation, and tightening monetary policies will have an adverse impact on investment in the region. Nevertheless, the longer-term prospects remain bright, as the ongoing restructuring of Asia's economies, in response to changes in comparative advantages, should provide numerous investment opportunities in the future. With Japan, Taiwan, and Korea shifting increasingly into high-technology industries, countries like Malaysia, the Philippines, and Indonesia are supplanting them in the production of light manufactures. In addition, greater investment flows from Asia's middle income countries to the region's less developed countries may be expected.

The current account deficits of most Asian countries are expected to swell as a result of rising oil import bills and weaker export growth. Despite the high degree of adaptability exhibited by Asia's manufacture-exporting countries and a switch from import-substitution to export- expansion policies among many developing countries, the slowdown in the developed countries' growth and rising trade barriers will constrain the expansion of Asia's exports. Most countries have accumulated substantial foreign exchange reserves and several have improved their external debt maturities through refinancing.

Bank of America NT&SA, founded in 1904 by A. P. Giannini, has over 1,000 branches in 500 California communities and more than 120 branches and representative offices overseas. As of June 30, 1979, the bank's consolidated assets were more than $95 billion.

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Economic Outlook 1981

Bank of America Global Report

September 1980

In global terms, 1981 promises to be a year of economic improvement. For the current cycle,1980 marks the low point in world growth at 2 percent, the peak in global inflation at more than 15 percent, and the record year for OPEC's current account surplus at $120 billion. The outlook for 1981 points to improvement in all three areas. The global economy is expected to recover and register a growth of about 2.5 percent, inflation should slow to approximately 14 percent, and the oil exporters' current account surplus should decline to less than $100 billion. While not vigorous, world economic trends will be heading up.

An increasing convergence in the rate of economic activity among leading nations will be a key characteristic of the global economy. The economic growth of countries that have performed well in 1979 and 1980, such as Japan and Germany, will slow until mid-1981, while those countries that have recently experienced economic downturns, such as the United States and the United Kingdom, will be expanding again.

The effects of sharp increases in oil prices, however, will continue to dominate the global economic scene in 1981. The structural adjustments brought on by the escalating price of petroleum are vast and far-reaching, impacting every sector of the world economy. Despite current moderation in demand for petroleum, the willingness of some OPEC nations to reduce production, and thus world supply, is likely to bring about further price increases. In 1981, the price of oil is expected to average $37 per barrel, compared with average prices of $31 in 1980 and $20 in 1979.

World trade will increase about 15 percent in 1981, somewhat slower than the 1980 growth rate of nearly 18 percent. Sluggish economic activity worldwide, high energy costs, and protectionist pressures in many countries are major factors restraining increased trade growth.

The World Economy

The 1980s: A Challenge to U.S. Leadership

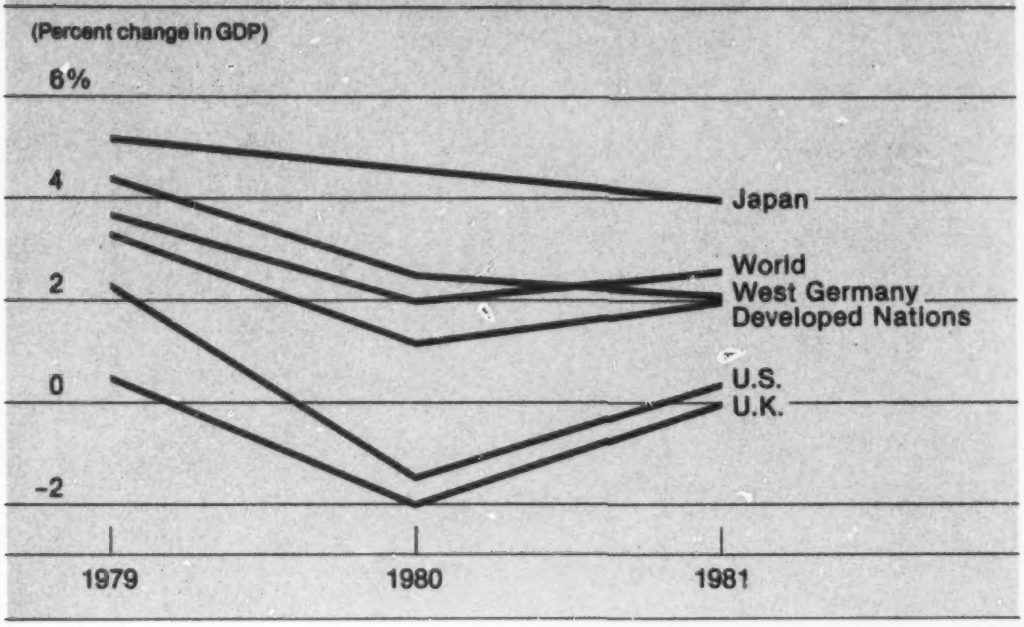
Global economic trends are no longer dominated by the sheer size of the U.S. economy. In 1950, for example, the U.S. accounted for 45 percent of the world's total GDP. Today, it accounts for only 25 percent (See Figure 1)—with the currently more buoyant economies of Japan, Germany, and some of the newly industrialized countries continuing to rise in importance.

Nevertheless, U.S. leadership in the world arena is still required for long-term progress in solving serious global economic problems. Purposeful leadership is needed in an interdependent world to avoid the waste of resources and energy which comes from uncoordinated attempts to deal with complex problems.

Within the United States, policy is being reoriented, away from stimulating demand and toward rejuvenating industry. This follows a realization that current U.S. economic difficulties are not cyclical in nature, but structural, and that the passage of time will not automatically bring about improvement. The new policy direction and greater realization of the interdependence of the world will—and must—enable the U.S. to reassert its world leadership role in the most productive sense.

FIG. 1 PERCENT OF 1980 WORLD GDP BY REGION

FIG. 2 CONVERGING RATES OF ECONOMIC ACTIVITY IN MAJOR INDUSTRIALIZED NATIONS



Converging Rates of Growth in Economies of Key Nations

Overall, the world economy is likely to grow by 2.5 percent in 1981—an improvement from the 2 percent gain expected for 1980—as the rates of economic activity converge for the key industrialized nations. (See Figure 2.) The United States and the United Kingdom are expected to record negative economic growth through 1980 before beginning a modest recovery in 1981. Economic growth in Japan will drop from about 5 percent in 1980 to approximately 4 percent in 1981. This decline will result from weakened export markets and reduced investments due to this year's slower growth in consumer spending. West Germany's rate of economic growth will drop to about 2 percent because of reduced government spending and a restrictive monetary policy, both instituted to bring down inflation and Germany's rising current account deficit.

The world inflation rate, as measured by the increase in consumer prices, will ease slightly to 14 percent in 1981, compared with more than 15 percent in 1980. (See Table 1.) The inflationary pressures caused by excessive monetary expansion of the mid-1970s will be somewhat reduced, and the overall slowing in the world economy also will have some salutary effects on the inflation front.

Although further price increases lie ahead, the peak pressures in commodity markets have passed. Many prices are currently falling due to reduced demand. Nevertheless, the high 1979 prices for raw materials are just beginning to be reflected in higher consumer prices.

Table 1. World Economic Summary

	GDP Level ($ billions)	Real GDP (percent change)			Inflation – CPI (percent change)		
	1980	1979	1980	1981	1979	1980	1981
World	$ 10,382	3.5	2.0	2.5	11.9	15.1	13.9
North America	2,927	2.6	-0.3	1.0	11.5	14.1	10.8
Latin America	498	5.4	5.2	5.3	38.8	46.3	35.5
Western Europe	3,366	3.2	1.6	2.6	10.9	12.5	9.8
Eastern Europe	1,200	2.1	4.0	2.0	—	—	—
Middle East & North Africa	440	6.4	6.0	4.9	9.8	17.1	16.4
Sub-Sahara Africa	282	2.5	2.6	3.8	21.0	23.5	28.0
Asia	1,680	5.2	4.6	4.0	6.5	11.3	8.2
Developed Countries*	7,480	3.3	1.0	2.0	9.9	12.4	9.4
OPEC Members	520	6.5	6.9	5.9	13.3	17.1	15.8
Non-OPEC Developing Countries*	1,102	5.0	4.7	5.3	37.8	44.9	29.5

* Centrally Planned Economies not included.

Bank of America estimates for 1980; forecasts for 1981.

Price gains for industrial commodities will slow throughout 1981, reflecting the continued slow pace of economic activity. For agricultural commodities, the major exception to the slowing trend in prices is in the world sugar market. The 1979-1980 consumption levels exceed production for the first time in five years, causing average sugar prices to surge upward.

Offsetting these positive factors, declining productivity growth in most industrial countries will continue to increase the cost of wages per unit of output, pushing up prices for finished goods. A purely temporary phenomenon adding to inflation and business costs in 1980 has been the increase in interest rates brought about by restrictive monetary policies in many countries. In general, however, worldwide interest costs have peaked for this cycle.

Although 1981 will bring a moderate reduction in the $120 billion OPEC current account surplus expected in 1980, continuing severe imbalances of international payments will characterize the global economy and force major structural changes throughout the world for years to come. It is fortunate, however, that individual current account deficits are now largely concentrated in those countries best able to finance them—most notably Japan and Germany.

Current Policy Response Keyed to Structural Changes

The current policy response adopted by major industrial nations to recent advances in oil prices differs markedly from the policies adopted subsequent to the 1973-1974 price boost. At that time, attention was focused on the shortfall in demand caused by the oil price increases, and highly stimulative policies were instituted.

The annual growth rate of the world's money supply was accelerated from an average of 11.6 percent in 1974 to over 15 percent in 1976. The increased money supply—in conjunction with a fall in the demand for money brought about by the 1974-1975 recession—set into motion powerful global inflationary forces that are still with us.

In contrast, the current restrictive policy stance is based on the recognition that oil price increases call for important structural changes in national economies. It is now widely acknowledged that a traditional policy of demand expansion would be inappropriate because it would not bring about the required adjustments. Instead, it would serve to keep factories open which are no longer economical to operate, thereby intensifying inflationary pressures.

Generally, current monetary policies are focused on the avoidance of excess liquidity. At the same time, fiscal policies are increasingly directed toward achieving necessary shifts in the industrial structure. These policies focus on increasing the supply of goods and services, encouraging capital investment, and avoiding broad tax cuts that would merely pump up aggregate demand.

Energy—Moderating Demand but No Major Price Relief Despite Temporary Oil Surplus

Increases in crude oil prices in 1981 will be substantially less than those of the past two years. OPEC prices will average $37 per barrel, a 19 percent increase over 1980—reflecting mainly the general inflationary forces. The smaller increase is a result of reduced demand for oil stemming from slower economic growth in the developed countries. However, the outlook must be tempered by the ever-present threat of disruption of oil supplies by one or two key OPEC members which could result in OPEC prices considerably above $37 per barrel.

In 1981, world oil consumption will approximately match the 1980 level of 50 million barrels per day. This follows a 3 percent drop in consumption in 1980, caused by the sharp increase in oil prices and the U.S. recession. Although oil prices will continue upward in 1981, there will not be much further downward adjustment in consumption.

The expected weak recovery of the U.S. economy in 1981 and slowing growth rates of other industrialized nations will generate an increase of about 2 percent in total energy consumption. U.S. consumption will remain almost constant due to increased energy efficiency and conservation, while other nations' consumption will increase about 3 percent.

The use of non-petroleum forms of energy will increase in 1981, led by a 5 percent increase in coal consumption and a 3 percent increase in the use of natural gas. Energy alternatives such as gas, coal, nuclear, and hydroelectric power are seen by all countries as means of moderating oil consumption in 1981, and of achieving significant reduction in oil consumption later in the decade.

Petroleum output of the OPEC nations has remained more or less stable since 1973 when OPEC produced 31 million barrels of oil a day. Other free world oil producers, however, have increased their output from 17 million barrels a day in 1973 to 22 million in 1980, and will increase to 23 million in 1981. Mexico and Egypt are among the countries increasing production most rapidly.

To maintain a balance of production and consumption, OPEC countries will reduce output to 27 million barrels per day in 1981 from 1980's 28 million barrels. Such a small production adjustment will prevent any deterioration in the existing price structure but will be insufficient to fulfill the hopes of some OPEC members for continued large price increases through 1981.

OPEC members are well aware that oil surpluses could depress prices in 1981 and, despite the lack of tight formal production agreements, member countries will be monitoring oil consumption closely and adjusting production accordingly. The major question is whether Saudi Arabia will curtail production sharply, if needed, to support prices in a weak demand environment.

Iran may cease all exports in light of deteriorating oil field facilities and indications of growing civil strife. With current Iranian oil production below 1 million barrels per day, the impact on world supplies would be minimal.

World Trade Growth Slows Again

The growth rate of world trade will slow considerably in 1980 and 1981. (See Table 2.) Following the peak growth rate of 24 percent in 1979, the value of world exports is expected to expand by approximately 18 percent in 1980 and 15 percent in 1981. After adjustment for inflation, world trade will grow at an annual rate of 2 to 3 percent in the early 1980s, compared with the 1970s' rate of 6 percent.

The developed countries, which account for nearly 70 percent of total exports, are expected to have modest real rates of export growth in 1980 and 1981. Regional trade blocs are becoming increasingly important. For example, intra-European trade, fostered by policies of the European Community (EC), now accounts for almost 60 percent of all exports by EC countries, while the United States receives only 8 percent.

While inflation rates remain relatively high, import demand will be reduced by restrictive monetary policies. Higher energy costs in importing countries will further compress non-oil purchases as income is diverted to pay for fuel imports. Finally, continuing high unemployment rates will increase pressure for individual governments to adopt protec-

Table 2. World Trade

	Exports ($ billions)	Exports (percent change)			Imports ($ billions)	Imports (percent change)		
	1980	1979	1980	1981	1980	1979	1980	1981
World	$1,660	23.8	17.9	14.9	$1,646	26.3	17.2	12.8
North America	302	28.5	24.6	15.6	328	21.9	20.0	14.6
Latin America	73	25.1	28.4	15.9	71	21.3	15.5	15.4
Western Europe	741	24.7	11.7	12.9	789	32.9	14.3	7.8
Eastern Europe	55	23.0	10.0	10.0	85	17.0	5.0	10.0
Middle East & North Africa	176	33.6	27.6	15.7	78	4.4	19.6	21.1
Sub-Sahara Africa	13	18.0	17.0	18.0	47	16.0	19.0	16.0
Asia	260	12.3	18.6	20.1	268	35.8	23.8	18.1
Developed Countries*	1,190	23.1	16.7	14.1	1,256	28.9	17.1	11.1
All OPEC	216	34.9	27.9	17.2	97	5.1	20.3	23.8
Non-OPEC Developing Countries*	179	24.0	28.5	23.4	210	29.0	28.1	21.6

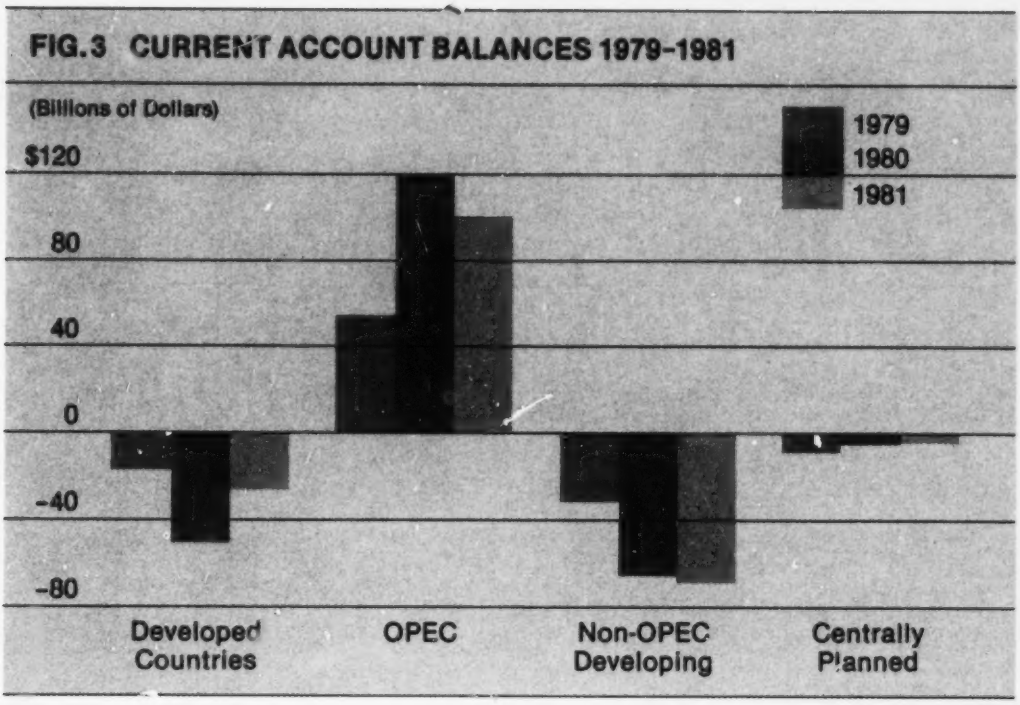
* Centrally Planned Economies not included.

Bank of America estimates for 1980; forecasts for 1981

tionist policies to safeguard domestic markets. These factors have slowed the momentum for worldwide growth of trade and it should not pick up again until national economies are fully recovered.

Slower trade growth will have a greater impact on the non-oil-exporting developing countries than on others. Their exports, which are concentrated in raw material products and semi-manufactured goods (textiles, footwear, processed food, and fibers), are the most affected by the slowdown in consumer demand. The low-income developing countries are seriously hurt since they need increased export earnings to finance industrial imports, achieve economies of scale, and stimulate economic development. In the absence of increased export earnings, by the mid-1980s they could lose much of the ground gained in the last decade.

The more advanced developing countries, which enjoy greater diversification in exports and markets, are better able to cope with the slower pace in the growth of trade. Their export development programs, however, have been financed by foreign borrowing, and a severe reduction in export earnings—as could be brought about by protectionist policies in the industrial



countries—would strain their financial resources and make it difficult for them to pursue aggressive development programs.

Some Improvement Seen for Current Account Balances

The current account surplus of OPEC countries will reach a record $120 billion in 1980. (See Figure 3.) This surplus will be mirrored by current account deficits of $65 billion in the non-OPEC developing countries, $50 billion in the industrial nations, and $5 billion in centrally planned economies.

The extreme current account disparity in favor of oil-exporting nations will be considerably improved in 1981 with a diminished OPEC surplus of less than $100 billion, and a deficit for the developed countries of approximately $26 billion. The developing nations, however, will see their collective deficit increase slightly from the 1980 level.

The OPEC nations that can absorb large inflows of capital may again set off a cycle of severe balance of payments distortions by pressing for price increases when their own accounts return to balance in a few years. Only the successful development of energy alternatives can offer an effective long-term check on further oil price increases.

The recycling of petrodollars will continue to be the dominant factor in international capital markets in 1981. For the last six years, responsibility for recycling oil surplus funds has fallen largely on the private international banking system. Some strains are becoming apparent in the recycling mechanisms, although there is good reason to expect the system to continue functioning well. The magnitude of the deficits both in 1980 and 1981,

however, suggests that international banks will be called upon to extend credit beyond existing levels.

In addition, other avenues for the recycling of OPEC funds will have to be found, and serious efforts are now under way to resolve the problem. Among the possible alternatives is the International Monetary Fund (IMF), which currently has approximately $14 billion in its general account plus $17 billion in special accounts available for loans. The IMF was a net borrower in 1979 (repayments exceeded new loans) because several member countries preferred to borrow commercially rather than be forced to accept the constraints associated with IMF loans. However, the IMF has already begun to pursue a much more active role.

In addition, financing will be available from public and private direct investment and from the World Bank, the Arab Monetary Fund, and the OPEC special fund. While overall lending resources are plentiful, their mixture may undergo some change, particularly beyond 1981.

There is also much room for innovative and cooperative arrangements between official development institutions and commercial banks. Loan guarantees by the IMF or World Bank for private financing, arranged within the framework of an official lending program, would not only increase financial resources available to borrowing countries, but also do so at lower cost. At the same time, the promise of additional financing through private channels would strengthen the position of the official institutions as focal points of the international monetary system. It should also be recognized that the non-oil developing countries have accumulated a reserve cushion totaling $75 billion. This amount excludes gold, which, if valued at a market price of $600 per ounce, would add another $60 billion.

Strength of Dollar Depends on U.S. Economic Performance and Global Portfolio Considerations

The outlook for dollar exchange rates in the last half of 1980 and in 1981 depends heavily on the length and depth of the current U.S. recession, on the level of continuing inflation, and on global portfolio considerations. A major factor expected to exert downward pressure on the dollar is the higher rate of inflation in the United States compared with many of its trading partners.

While there are difficulties associated with international price comparisons, inflation will have an effect on exchange markets. For example, the U.S. inflation rate as measured by the Wholesale Price Index—the measure most relevant to international trade—is expected to be 12 percent in 1981, compared with Germany's 6 percent and Japan's 8 percent. Other factors being equal, this would cause the dollar to depreciate by roughly the amount by which the U.S. inflation rate will exceed inflation rates abroad in 1981.

However, the United States is now in the midst of a recession, while economic growth for many of its trading partners—though

slowing—remains positive. As a result, the U.S. current account is expected to register a surplus of $4 billion in 1980 and be roughly in balance in 1981. The current accounts of most other major countries will be in deficit due primarily to the impact of the recent surge in oil prices. Germany is expected to have current account deficits of about $15 billion in 1980 and $5 billion in 1981, while the comparable deficits for Japan are $15 billion and $10 billion. The stronger U.S. current account position will partially offset a relatively unfavorable inflation performance.

The U.S. election will also influence the exchange value of the dollar since perceptions formed about the future course of the U.S. economy will have an impact on the foreign exchange markets. Relatively high market volatility may be expected until the market participants have firmed up their view regarding post-election U.S. policy and the dollar's value.

These developments must be seen against the backdrop of the declining role of the United States in the world economy and the emergence of increasingly attractive alternative investment currencies, such as the Japanese yen, the Deutsche mark, and the Swiss franc. Portfolio diversification by current dollar holders will exert continuing downward pressure on the dollar. It is important for the U.S. government to work in concert with other nations through the international organizations to resolve these potentially destabilizing factors before they further impact the value of the dollar.

Regional Analysis

U.S. Economic Outlook—Turnaround Expected in 1981

The U.S. economy is expected to continue downward very slowly for the rest of 1980 with positive events supplying an underlying vitality to the economy before it decisively emerges from the recession in the first half of 1981. The impact of the recession will be felt much more severely in eastern states than in the West. With the expected enactment of a $30 billion tax cut, the economy should finish 1981 with a slight overall growth in real GDP. (See Table 3.)

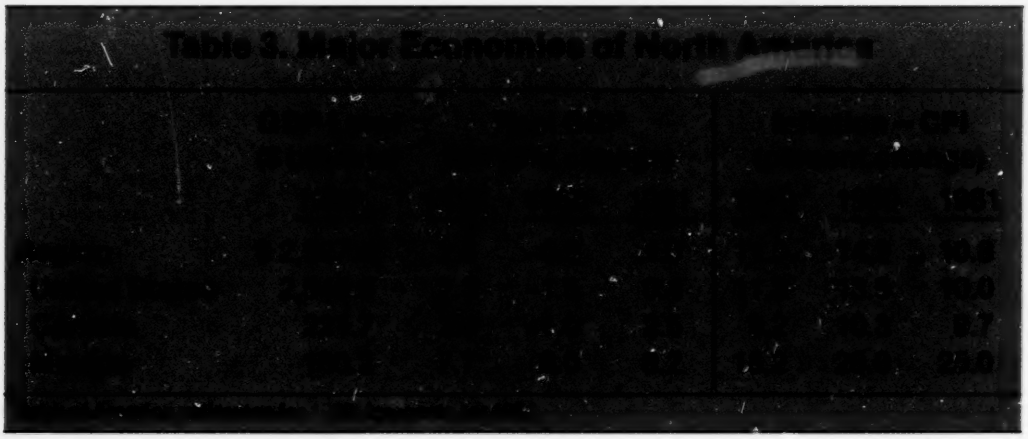
Among the variables which affect this recession and recovery are the extent of the 1980 cutback in new home purchases and household spending for consumer goods, the size of surplus business inventories which must be worked off, the strength of business fixed investment, and the stance of fiscal and monetary policies.

There is ample reason to expect an upturn in the first half of 1981. For instance, the cutback in consumer spending has reflected the debilitating effect of inflation on net income, historically high interest rates, restricted credit, and low consumer confidence.

In the second half of 1980, all of these negative forces are diminishing. Increased housing demand will be supported by demographic forces, primarily by continuing growth of the young adult population—25 to 35 year olds. In addition, a year of deferred expenditures should create a strong demand for durable goods, including autos.

By historical standards, however, the recovery will be slow. Structural problems in the economy, such as those related to energy, deteriorating plant capacity, declining productivity and loss of competitive edge, decreasing importance of the dollar, and entrenched inflationary biases, will impede a rapid recovery.

Cyclical swings, which have



become far less important to the economy, are now occurring against the background of a reduced growth rate trend for the nation's real GDP. Over the past 10 years, this rate has declined to about 2.5 percent from the historical average of 3.5 percent.

Also, inflation will still be high enough to constitute a drag on growth in real disposable incomes. Long-term interest rates will still be high, retarding investment, and—with plants still operating below capacity—strong business investment growth is unlikely in the absence of positive strong tax incentives.

Moderate increases in energy prices and somewhat reduced mortgage rates could bring the consumer price index below 9 percent in the second half of 1980. However, such a development would not be likely to last since it does not reflect the underlying or trend rate of inflation (GDP deflator). This measure is expected to increase about 9.5 percent in 1981—dangerously close to the double-digit level as a new economic expansion begins.

To prevent inflation from moving into a two-figure rate, consistent anti-inflation policies must be pursued. A tax cut package in the magnitude of $30 billion is anticipated for 1981. Though a deteriorating economy and the political appeal of a cut make such a move likely, the effects of the tax reduction would probably not be felt until recovery from recession was already under way. Because the results of tax cuts only begin to appear after a lag of six months, the main effects of a 1981 cut would be psychological and on the *scale* of recovery. Without a tax cut, real growth would be cut by about 0.5 percent in 1981, giving the U.S. negative growth for two consecutive years. Curbing inflation demands that any change in fiscal policy be directed chiefly toward stimulating savings, investment, and supply—rather than stimulating demand.

It is also important to pursue a monetary policy designed to reduce inflation through a long-term commitment to the steady reduction in the growth of money. Renewed monetary expansion aimed at stimulating the economic recovery could erode the gains of recent restraint. Moreover, given the long lags in the effectiveness of monetary policy, such stimulus may well come too late to soften the current recession, while running the risk of adding to inflationary pressures in the expected upswing.

Canada—Stronger than U.S. Recovery

In 1981, the Canadian economy will begin recovering from the 1980 recession. The recovery will be stronger than in the United States, with real GDP expected to grow 2.5 percent, after declining 1 percent in 1980. (See Table 3.) Inflation is expected to remain around 10 percent, due to accelerating labor costs and anticipated oil price decontrol.

The Canadian recovery will be boosted by improvement in exports, especially building materials and machinery, component parts, and other manufactured goods needed by the reviving U.S. housing and auto industries.

Despite some appreciation of the Canadian dollar against the U.S. dollar in 1980, Canadian manufacturers will remain relatively competitive.

Domestically, business investment in plant and equipment will continue to be the most vital sector in the economy, following the trend set in 1979. Investment will be particularly strong in the energy, mining, and manufacturing industries. When reached, the long-awaited energy pricing agreement between the Canadian government and Alberta is likely to stimulate further energy investment and the search for new gas and oil reserves in the Arctic and North Atlantic Oceans.

Domestic demand should revive throughout the economy after the 1980 inventory overhang is reduced. After a prolonged decline through 1980, residential construction should turn around, adding some strength to the economy.

Canada will continue to draw on the international capital market by keeping interest rates high, although rates should be somewhat lower than in 1980.

Mexico—Leads Growth in North America

Following the pattern established over the past two years, Mexico's gross domestic product will show real growth of 8.2 percent in 1981—compared with 8 percent in 1980. Growth will be concentrated in the manufacturing sectors—particularly in petroleum, petrochemicals, and construction.

Inflation—which will decrease modestly to 25 percent from the estimated 28 percent of 1980—will be fueled by further deficit financing as the government attempts to employ as many as possible of the 400,000 new workers who enter the work force each year. Some 11 million workers are now either under-employed or unemployed. The anticipated government deficit for 1981 will be approximately $9 billion, about 4 percent of Mexico's GDP. The deficit will be financed through increasing the money supply, continuing a long-term trend.

Externally, the Mexican economy will be boosted by revenue from exported oil in 1981. Mexico expects to export approximately 500 million barrels of oil in 1981 at an average price of $38 a barrel. These exports will bring Mexico's trade account into balance, although its current account deficit will persist.

Latin America—Progress Continues

Relative to most of the world, the outlook for Latin America is very positive for 1981. The real gross domestic product for the region will increase over 5 percent—twice as fast as for the world as a whole. Inflation, which will average about 50 percent in 1980, should be reduced somewhat in 1981. (See Table 4.)

Optimism for the year's performance is based in large part on the increased economic diversity of the region's leading countries, which are now in position to adapt more easily to changing world market conditions, and also on the fact that the region is a net exporter of petroleum. Another positive factor for 1981

Table 4. Major Economies of Latin America

	GDP Level ($ billions)	Real GDP (percent change)			Inflation – CPI (percent change)		
	1980	1979	1980e	1981	1979	1980	1981
Region	$ 498.0	5.4	5.2	5.3	38.8	46.3	35.5
Brazil	195.8	6.2	5.5	5.8	52.7	64.8	50.0
Argentina	68.7	8.4	3.0	5.0	159.5	100.0	60.0
Venezuela	53.9	3.7	5.2	5 e	12.3	22.0	18.0

Bank of America estimates for 1980; forecasts for 1981.

and beyond is the carefully paced return to political democracy by many Latin American nations. This will encourage continued foreign investment in the region.

In trade, the overall merchandise surplus is forecast at about $3 billion, based on exports of $85 billion and imports of $82 billion. This surplus will be $700 million larger than that in 1980. Capital goods, needed to support the rapidly growing economies of many Latin American nations, will account for a significant share of imports. Of the exports, nearly one-third will originate in countries which are petroleum exporters—*Venezuela, Trinidad, Ecuador,* and *Peru*—all of which will enjoy large trade surpluses. Of greater significance for Latin America's economy in the long run, however, are its rapidly growing exports of manufactured and processed goods.

Brazil, which has made a determined effort to broaden its industrial base and to diversify exports, expects to earn $25 billion from exports, targeting $3 billion in earnings from overseas automobile sales alone. Commodity exports, including agricultural products, will increase significantly —with a high percentage of these commodities shipped in processed form.

The nation's inflation rate is expected to moderate somewhat, even though Brazil continues to be vulnerable to the rising price of oil because of its dependence on imported fuel. The Brazilian economic picture also includes a large foreign debt, which should rise to $60 billion by the end of 1981. Most of this debt, however, is connected with investment in industrialization and in production of exports, which have increased threefold since 1974. Because Brazil produces nearly 40 percent of the region's income and output, it dominates Latin America's overall balance sheet.

Chile, having reduced its inflation to manageable levels, will continue to use currency earned from traditional exports to finance export diversification in 1981. New export products will account for 33 percent of the nation's 1980 overseas sales.

Argentina, which brought its inflation rate down from almost 160 percent in 1979 to 100 percent in 1980, anticipates a 60 percent in-

crease in prices in 1981. Its imports and exports should each rise about 20 percent, leaving the trade balance still slightly negative. For exports, the country will continue to rely on its traditional base of meat, hides, and grains.

Western Europe—Recovery in Late 1981

In Western Europe, real GDP is expected to increase 2.6 percent in 1981, slightly faster than 1980's rate of 1.6 percent. (See Table 5.) Inflation will slow from 12.5 percent in 1980 to 10 percent in 1981. A high level of political stability will provide the framework to carry out temporary but probably unpopular adjustment policies needed to set the stage for the resumption of economic growth in late 1981. Labor strife, however, will accompany these policies in many countries.

Export earnings, always of vital importance to West European nations, are expected to increase by almost 13 percent, against only a 7 percent growth in imports. As with other regions, the overall picture masks significant differences among individual countries. The current accounts—which include, besides trade, such "invisibles" as service flows, investment earnings, and foreign aid—are expected to be in deficit by $40 billion in 1980 and by $30 to $35 billion in 1981. Although in absolute terms a deficit of this magnitude is enormous, it represents only about 1 percent of Western Europe's total GDP. Thus, it should not present a critical problem for the region as a whole.

Looking at countries' individual current accounts, the *United Kingdom, Italy, Norway,* and *Switzerland* will be more or less in balance, while *West Germany* and *France*—with anticipated imported oil bills of more than $40 billion and $25 billion, respectively—will experience large deficits. However, these countries should not have difficulty in financing these deficits through capital inflow.

Domestically, most countries in the European Monetary System are combating the inflationary pressures arising from increased oil prices by restraining growth of their money supplies. The restrictive policies, however, are not ex-

Table 5. Major Economies of Western Europe

	GDP Level ($ billions)	Real GDP (percent change)			Inflation – CPI (percent change)		
	1980	1979	1980	1981	1979	1980	1981
Region	$ 3,366.0	3.2	1.6	2.6	10.9	12.5	9.8
West Germany	807.1	4.4	2.5	2.1	4.1	5.1	4.0
France	618.9	3.8	2.0	2.3	10.7	11.3	9.7
United Kingdom	477.8	0.5	-2.0	0.0	13.4	17.5	13.8
Italy	353.9	5.0	2.4	1.5	14.7	18.1	13.9

Bank of America estimates for 1980; forecasts for 1981.

pected to trigger a recession in continental Western Europe. *France* and *Germany* are expected to continue investing in long-term programs to restructure their economies and will therefore invest heavily in energy-saving projects and in the development of alternative energy sources.

The government of the *United Kingdom*, under mandate to bring down inflation and restructure the economy from a strong welfare-state orientation to greater free enterprise, will continue to tolerate high corporate bankruptcy and unemployment rates, even though labor strife may continue in 1981.

For the *Scandinavian countries*, including Denmark but excluding oil-exporting Norway, monetary restraint in 1981 will trigger a recession. These countries have long embraced policies of heavy state-subsidization of industrial employment—policies which are weighing down their economies today and impeding the structural reforms needed to restore their cost competitiveness in the international marketplace.

Eastern Europe—May Stagnate in 1981

The slowing of economic growth in Eastern Europe was a significant factor in triggering political unrest in Poland, which points to the urgent necessity of improving economic performance throughout the region. The overall development strategy for many of these countries—using Western credit for large-scale imports of Western technology—has not worked out as successfully as envisioned due to many factors. Among these are the inability of the countries to absorb the new technologies and disappointing export performances.

Without comprehensive political and economic reforms, growth rates in Eastern Europe will decline from 4 percent in 1980 to 2 percent in 1981. (See Table 6.) Under the burden of in-

Table 6. Major Economies of Eastern Europe

	GDP Level ($ billions)	Per Capita GDP	Real Net Material Product (percent change)		
	1980	1980	1979	1980	1981
Region	$ 1,200.0	$ 3,000	2.1	4.0	2.0
U.S.S.R.	720.0	2,800	2.0	4.0	2.0
Poland	120.0	3,500	2.0	2.0	1.0
East Germany	75.0	4,500	4.0	4.5	3.0
Yugoslavia	65.0	3,000	7.0	5.0	4.0
Hungary	40.0	3,700	1.5	3.0	2.0

Bank of America estimates for 1980; forecasts for 1981.

Table 7. Major Economies of the Middle East and North Africa

	GDP Level ($ billions)	Real GDP (percent change)			Inflation – CPI* (percent change)		
	1980	1979	1980	1981	1979	1980	1981
Region	$ 440.0	6.4	6.0	4.9	9.8	17.1	18.4
Saudi Arabia	140.3	7.1	7.0	7.0	10.0	10.0	10.0
Algeria	38.3	9.0	8.9	9.0	17.0	16.0	15.0
Israel	24.6	3.0	1.0	1.0	78.3	78.0	75.0
Egypt	16.9	8.0	8.0	8.4	13.0	19.9	19.8

*All Middle East and North Africa countries, except Israel, keep consumer prices artificially low through large subsidy programs.

Bank of America estimates for 1980; forecasts for 1981.

creasing energy costs, the region may actually stagnate for the first time since World War II.

In real terms, East-West trade will remain at current levels, however—about $120 billion in 1980—since trading patterns established in the 1970s will be maintained and close ties exist between many East and West European countries. Numerous raw materials, capital goods, and grain imports are essential to the Eastern European economies. Their increased productive capacity—combined with long-term export agreements, the need to earn hard currency, and general price increases—will result in some growth of exports. Continued access to current account deficit financing will undoubtedly prove critical to the 1981 outlook for many East European countries.

Middle East and North Africa—Slower Growth

The Middle East and North Africa will continue to undergo structural changes in 1981 and beyond. Strong cultural, religious, and economic affinities among various nations have substantial impact throughout the region, crossing boundaries, weakening national political structures, and fostering general instability.

OPEC members, fearing too rapid development which carries the potential for creating social tensions, will limit government spending in 1981. Due to this go-slow policy for domestic development and to difficulties in investing their surplus funds profitably and safely, OPEC nations will increasingly consider leaving more of their oil wealth in the ground. Domestically, inflation will continue to be a problem for the OPEC nations.

Among the OPEC nations, *Iraq* and *Algeria* have enough natural resources and development potential to grow about 9 percent in real terms in 1981. (See Table 7.) *Kuwait, Saudi Arabia,* and *United Arab Emirates*—although their financial reserves are enormous

—have neither the ability to successfully assimilate such growth nor the skilled labor to undertake extensive domestic programs. They can be expected to limit the importation of labor as part of their go-slow domestic policies. *Libya's* economy will continue to be plagued by economic mismanagement and suffer from critical shortages of technicians. Political turmoil in *Iran* will continue to disrupt that economy and cause economic stagnation for the next few years.

Non-OPEC nations face growing current account deficits and further constraints on their foreign exchange earnings, which will limit their import capacity and adversely affect their economic growth in 1981. Their aggregate current account deficit will reach approximately $16 billion in 1981, representing 20 percent of their total gross domestic product.

Israel is pursuing a rapid growth policy, which relies heavily on production for export. However, inflation, expected to be 78 percent in 1980 and 75 percent in 1981, is considered a serious and politically destabilizing problem, suggesting that future economic policy will stress slower growth and reduced inflation. *Egypt* is also expected to give high priority to combating inflation to improve its export competitiveness. *Tunisia, Jordan, Morocco,* and *Pakistan* will derive much of their growth from the export of agriculture and raw materials—even though the value of these exports will not substantially increase in 1981.

Sub-Sahara Africa—Continuing Economic Troubles

With few exceptions, the 1981 prospects for the 47 economies of Sub-Sahara Africa are not good. The rapidly rising real cost of imported oil and stagnant export markets, combined with deteriorating terms of trade, will increase their current account deficits from $9 billion in 1980 to $11 billion in 1981. A mounting demand for grain imports will contribute to this deficit.

Many of these nations have pursued overly expansive domestic programs, fostering acceler-

Table 8. Major Economies of Sub-Sahara Africa

	GDP Level ($ billions)	Real GDP (percent change)			Inflation – CPI (percent change)		
	1980	1979	1980	1981	1979	1980	1981
Region	$ 262.0	2.5	2.6	3.8	21.0	23.5	28.0
Nigeria	46.1	5.2	5.5	6.4	22.0	20.0	24.0
South Africa	45.7	4.0	4.5	4.2	16.2	17.5	19.0
Ivory Coast	9.4	4.2	4.0	4.5	21.8	19.8	18.5
Kenya	7.0	5.5	3.6	3.0	20.0	21.5	24.0

Bank of America estimates for 1980; forecasts for 1981

Table 9. Major Economies of Asia

	GDP Level ($ billions)	Real GDP (percent change)			Inflation – CPI (percent change)		
	1980	1979	1980	1981	1979	1980	1981
Region	$ 1,689.0	5.2	4.6	4.0	6.5	11.3	8.2
Japan	1,063.8	6.1	5.1	3.7	3.6	9.0	6.0
Australia	136.7	4.5	2.5	3.0	9.1	11.0	9.0
Korea	67.4	7.4	3.5	4.7	18.3	35.0	24.6
Taiwan	36.1	8.0	6.0	7.0	9.8	14.0	8.1

Bank of America estimates for 1980; forecasts for 1981.

ated inflation—due to reach an average of 28 percent in 1981. (See Table 8.) Inflation rates would be higher without International Monetary Fund stabilization measures now in effect in many Sub-Sahara nations including *Gabon, Ghana, Sudan, Zaire,* and *Zambia.*

With the exception of the food surplus countries of South Africa and Zimbabwe, the general performance of agriculture will remain poor through 1981, adding stress in an area where the population increases about 2.9 percent a year (versus the world average of 1.8 percent). Added to the strains of a population growing faster than the region's capacity for food production are the diverse national political struggles and the huge migration of refugees, which currently number more than 4 million.

Real GDP is expected to grow over 2.5 percent in 1980 and almost 4 percent in 1981—reflecting more the fortunes of a few nations rather than that of the region as a whole. These pockets of relative prosperity include *Cameroon, Gabon, Ivory Coast, Kenya, Malawi, Nigeria, South Africa,* and *Zimbabwe.*

Asia—Brighter Second Half

Until mid-1981 Asia will be confronted with weakening export markets of the industrial countries, rising protectionism, increased costs of energy, and a high level of inflation. Assuming that oil prices will not rise more steeply than anticipated, inflation is expected to moderate—to slightly over 8 percent during 1981—as a result of the tight monetary and fiscal policies which most Asian nations have followed since late 1979. A slower growth of GDP, to 4 percent in 1981, will also cool inflation. (See Table 9.) The slowdown will result from sluggish investment in reaction to increasing uncertainties, tight credit, weakening consumer expenditures, and deteriorating current accounts.

Gradual recovery in economic activity is expected to commence in the latter half of 1981 as governments, encouraged by moderating inflation, initiate

more expansive economic policies. Foreign investment will continue to flow into many Asian nations because of their adaptability to changing economic environments and to their relatively high rates of productivity.

Real economic growth in *Japan* will continue to decelerate into the first quarter of 1981—even with an earlier decline in interest rates and more stimulative monetary expansion. Japan's 4 percent growth rate for 1981, however, will still be enviable by world standards. A solid economic recovery should begin to surface in next year's fourth quarter when export markets are expected to strengthen. This should help Japan reduce its balance of payments deficit in 1981.

Other Asian countries, including *Korea* and *Thailand*, face some danger of reflating their economies too early in order to maintain popular support. This would be at the expense of solid recovery later on. Opportunities will exist for *Korea, Taiwan, Hong Kong,* and *Singapore* to further develop their high-technology industries which do not require massive research and development efforts and are not energy intensive.

The *People's Republic of China* will play a stabilizing role in the Asia-Pacific area, thus improving the overall economic and political climate.

In Southeast Asian countries—including the *Philippines, Malaysia,* and *Indonesia*—growth prospects are good in labor-intensive manufacturing industries, the processing of local natural resources, and in the energy resources area.

Bank of America NT&SA, founded in 1904 by A. P. Giannini, has over 1,100 branches in California communities and 130 branches and representative offices overseas. As of June 30, 1980, the bank's consolidated assets were more than $103 billion.

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